

## Today's Notes:

1. JUST SAY NO
2. THE NEW CURRENCY STANDARD IS COMING

## 1. JUST SAY NO

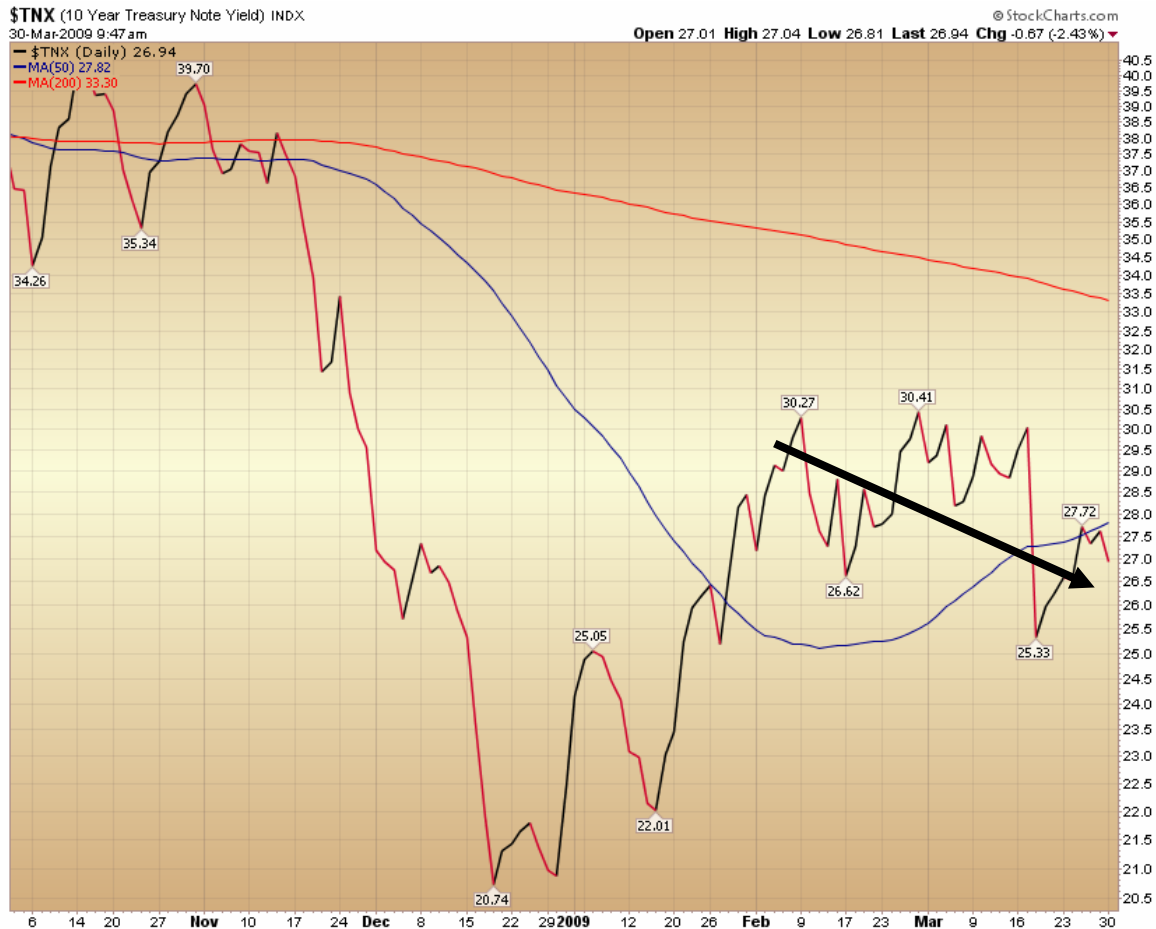
Here we are again. The US currency this AM is stronger relative to all other of its fiat cousins. Much stronger in fact. Japan's Yen is also stronger this AM. This puts us in the mindset of July through December 2008, when dollars were sought everywhere to reverse leverage and carry trades. This process continued for 6 months and the global liquidation and asset value destruction that ensued marked down the world's wealth by 50%. The damage to household balance sheets has been so extensive that while **we are now at the end of the beginning** and we may have seen the equity market bottom, the future recovery will be long and weak. Today the stronger US dollar has once again had its impact on the commodity markets. Oil and natural gas are trading down. Oil is at the \$50.03 level enough to keep most of the OPEC nations, sans Iran, Venezuela and Russia (still non-OPEC), out of serious budgetary trouble. However the International Energy Forum (IEF) notes that \$50 oil will not attract the \$12 trillion in oil and gas investments necessary to continue to adequately supply the world by 2030. Noe van Hulst of the IEF said yesterday,

*“Around 12 trillion dollars of investments are needed in the oil and gas sector by 2030, or nearly 500 billion dollars per annum, to maintain market balance,”*

Be informed that the boom / bust energy cycle we have recently experienced is about to become and Boom / bust/ boom cycle within a short few years, at most. This will swing geopolitical factors rapidly back in favor of our erstwhile foes in Iran, Venezuela and Russia. Washington can crow all it wants to about green energy but it cannot be a base load factor for a decade or two. **Therefore it will be critical for the Obama Administration to embrace conventional (yes, that means carbon-based) oil and gas production in this country – at least for the interim of this decade and the next.**

The precious metals are trading down and so are the soft commodities. Even our old friend copper has declined almost 4% this AM after a strong run over the past two months. Therefore I do not interpret the recent strength of copper as a show of strength for the overall economy.

Instead, it is becoming clear to me that most of these commodities were so oversold in the chaos beginning in July 2008 that they have bounced back into reasonable ranges - for the time being. At the same time Treasury yields are falling, though not dramatically. The Ten year Treasury is yielding 2.69% and has declined. If a neutral observer had just arrived in town from Mars, she would have to conclude that the US economy was mired in the beginning of a deflationary spiral. As you can see in the following chart the Ten Year failed at 3.04% (due to the Fed's Quantitative easing plans) It is true that the Fed and Treasury want to see interest rates, especially on mortgages lower in order to stimulate lending and borrowing. We'll see how that works out.



There is some good news this AM. The plans submitted by GM and Chrysler were rejected by President Obama's auto team. Rick Wagoner, CEO of GM has been asked to resign after nine futile years at the head of GM's rescue attempt. It is now apparent that GM will enter bankruptcy and be reorganized. We shall now see if the admonition of the auto leaders that, "no one wants to buy a car from a bankrupt carmaker," will come true. Chrysler and the Canadian Auto Workers are also at a standstill on the request for a \$2 billion bailout package to come from Ottawa. The damage to the economy of Ontario will be very much more severe if the Chrysler and its CAW relationship is forced into bankruptcy. Ontario has several hundred thousand auto workers between Ford, Chrysler and GM. Finally the bondholders in these companies stand to be big losers along with the already depleted shareholder wealth.

To date Canada's economy has been relatively shielded from the perils of its southern neighbour. That may be changed as a result of the forthcoming auto bankruptcies. Why, you ask, is this good news? Because it is time that someone in Washington finally steps up realizes the plight of the country and says, "No." We cannot be a bailout nation for ever. One now must wonder about the solvency of GE and other pseudo finance and shadow banking entities.

The equity markets do not like this news and they are selling off by 3+% as I write. You may remember that the Bush Administration, in one of its last significant gasps, awarded the automakers a \$14 billion loan to allow them to stay alive. I wonder if any of that money

shall find its way back to taxpayers? Take another look at the Bush loan. If it had been made to revive the nuclear industry instead, two to three nuclear plants with redundant reactors could have been built. Which is the better deal for America?

## **2. THE UNITED NATION'S NEW CURRENCY STANDARD**

One would have to agree that the dollar is under pressure worldwide. With interest rates low and falling you might expect the dollar to decline but this day it is stronger relative to all other currencies. Most of the rest of the world economies are perceived by currency investors to be in far worse shape than the US, a fact almost always overlooked. Iceland, Latvia and the Czech Republic have all experienced governmental changes as a result of the problems. Hungary, Romania and Austria have serious banking and debt problems and are on the verge of further devaluation and much lower relative currency values. Therefore the Canadian Loonie and the Aussie dollar are my favorite currencies at present. I think the Canadian story is fantastic. By that I mean it is time to pick up tremendous Canadian values. Why? The Loonie is going to strengthen relative to the dollar and most of the European currencies. You see we will eventually recover but by the time the recovery (2010?) becomes obvious you will have missed your chance. Canada is a commodity backed country. From Nova Scotia to British Columbia the relative sparse population controls, significant energy, water, fertilizer, food and metal assets. All these shall be in demand eventually.

In the past few weeks the pressure has increased on the role of the US dollar as the world's reserve currency. I have oft made the case that the US has beggared the world for the past 40 years (just look at a long term graph of the US currency) by decoupling from gold (1971) and consistently devaluing the greenback while exporting inflation. In recent years China played the perfect partner. When the dollar was tied to gold in the 1960s the French started sending dollars back to Washington in return for gold – they understood concerns of the dollar early on. The only counter example of dollar strength was when Paul Volcker raised rates in 1981 to kill inflation.

This AM Russia requested that the dollar be replaced as the sole reserve currency with combination of gold, roubles and Yuan. A senior Kremlin aide, Andre Dvorkovich said,

***"It would be logical for the set of currencies (that make up the SDR) to be expanded, and it could include other currencies, including the rouble, the Yuan and perhaps others,"***

***"We could also think about more effective use of gold and gold and forex reserves in this system,"***

Now this is not likely to happen at the G20 meetings this week, nor perhaps for another year or two. But there is one very central weakness that the US now must face. We are net borrowers from the Chinese and others. They now have some say in the currency management of the rest of the world. It is a topic that shall take on increasing importance as we move through the 2010 / 2015 timeframe.

Last Thursday we received reports of another vastly more important “nail” in the dollar's coffin. Nobel Laureate Joseph Stiglitz, one of President Obama's advisers, has also

recommended the use of IMF Special Drawing Rights, perhaps backed by commodities for world trade. This is a most significant occurrence in my view. Stiglitz heads a UN expert panel analyzing the financial crisis and recommending reforms. On Thursday March 26<sup>th</sup> he noted,

*“There is a growing consensus that there are problems with the dollar reserve system, ... economists have been discussing the weaknesses of single-currency reserve systems for decades. One of the problems (with single currency reserves) is that because of the huge level of volatility, countries are accumulating large amounts of reserves, ... the dollar reserve system is relatively volatile, deflationary, unstable and (had) inequity associated with it, ... the use of dollar reserves contributes to the weakness of the global economy... developing countries have been lending the United States trillions of dollars at almost zero interest rates when they themselves desperately need that money.”*

This is one of the President's men!!!! I do not think that the Obama Administration, particularly after the Geithner gaff (or was it?) on the Chinese proposal that for a new reserve currency system, will be able to resist for long. **One certainty of this global crisis is that the world will now be forced, possibly through the straw man issue of global warming, to develop a new playing field in currencies.** Over the long term, currency inequality backed by US military strength and no appropriate backing for the dollar has led us all into this trap. The Obama Administration has already shown in other efforts (Iran for example) that it will give on this issue before long. Stay tuned and begin to accumulate the commodity currencies.

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